No. 14,760

IN THE

United States Court of Appeals

For the Ninth Circuit

JACK SHOWELL AND DOROTHY SHOWELL,
Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Brief for Petitioners

On Petitions for Review of the Decisions of The Tax Court of the United States.

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SUBJECT INDEX

TABLE OF AUTHORITIES CITED

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OPINION BELOW

The only previous opinion is that of the Tax Court of the United States promulgated December 16, 1954. The findings of fact and opinion of the Tax Court are reported at 23 T.C. 495.

JURISDICTION

This appeal involves income taxes. By two notices of deficiency, each dated February 26, 1953, addressed separately to Jack Showell

and Dorothy Showell, the Commissioner of Internal Revenue determined deficiencies of $3,946.65 and $4,065.69 respectively for the taxable year 1949 (R. 6, 7, 121). Identical petitions, under the authority of Section 272 (a) of the Internal Revenue Code of 1939, were filed in each case with the Tax Court of the United States on April 30, 1953 for a redetermination of the deficiency set forth in each notice of deficiency (R. 4, 121). The decisions of the Tax Court were entered on January 26, 1955 (R. 27, 28). Said decisions found that there was a deficiency in income tax for Jack Showell in the amount of $3,286.65, and a deficiency in income tax for Dorothy Showell in the amount of $3,392.25. The cases were brought to this Court by separate Petitions for Review filed on March 9, 1955 (R. 29, 121). The jurisdiction of this Court to review the aforesaid decisions of the Tax Court is founded on Sections 7482 and 7483 of the Internal Revenue Code of 1954.

STATEMENT OF THE CASE AND QUESTIONS PRESENTED

Instead of asserting deficiencies on the basis of either the bank deposits or net worth and disbursements methods, the Commissioner relied wholly on the correctness and veracity of petitioners' own permanent record, in evidence as Exhibit 3, as the sole basis of his deficiency notices (R. 45). This fact is revealed by the testimony of the examining agent, U. S. Internal Revenue Agent H. L. Mende, who testified on direct examination as follows:

> "Q. Mr. Mende, is the Exhibit 3, which is now in evidence, the only source of the amount of $11,281.83 set forth in the notices of deficiency?
>
> A. To the best of my knowledge and belief, it is." (R. 45).

Thus, it was found that all of the entries appearing in the "Gain" column of Exhibit 3 were accepted by the Commissioner while all, except four entries representing certain expense items, in the "Loss" column were rejected (R. 16-18, 51). Such action was taken by the Commissioner in spite of the fact that the entries made in both the "Gain" and "Loss" columns were net gains or net losses (R. 15). That is, the total of all losing bets was deducted from the total of all winning bets and the resulting net gain or net

loss entered on Exhibit 3 under the "Gain" column if a net gain or the "Loss" column if a net loss (R. 14, 15). In explaining the above *method* used to determine petitioners' correct income, the examining agent testified as follows:

> "Q. Were any of the gains or losses used in computing the 'Gain' column substantiated?
>
> A. No more than the losses.
>
> Q. In other words, is it correct to say that you accepted all of the amounts in the 'Gain' column and rejected all the amounts in the 'Loss' column?
>
> A. Except those expenses I told you about." (R. 51).

From the above material, it is clear that the Commissioner accepted the method of accounting regularly employed by petitioners (R. 104), and the truthfulness and accuracy of his permanent record (Exhibit 3) for the purpose of computing and asserting deficiencies in tax. However, it is also equally clear that the Commissioner rejected the same method of accounting, and the accuracy and truthfulness of the same record or piece of paper (Exhibit 3) when any entries resulted in the conclusion that no additional income had been realized.

No testimony or evidence of any kind was introduced by the Commissioner at the trial of this cause except for the original 1949 federal income tax return of each petitioner. In fact, the Commissioner's counsel frankly stated in the opening statement:

> ". . . You may wonder why we are here in such a case, but this is somewhat of a test case to see how far a person engaged in the betting and booking business may operate without keeping the usual records which are kept by a merchant and a man in business . . ." (R. 39).

The Tax Court sustained the Commissioner's action in substance by holding that the "Loss" column entries were reliable only to the extent of $3,000 more than the four expense item entries. The Tax Court did not state which of the entries were reliable and which were unreliable, or why the "Loss" column entries were reliable only $3,000 worth. The effect of this finding was to disregard a total of $20,144.77 in record entries appearing in the "Loss" column (R. 17, 18).

With the above summary in mind, petitioners' counsel state frankly to this Court that this appeal was taken in the belief that the record will show that rules of evidence, the rules respecting legal presumptions and burdens of proof, the record, and federal income tax law have all suffered as a result of the irrelevant fact of the nature of one of petitioners' businesses in 1949.

The first issue before this Court arises from the decisions of the Tax Court sustaining the deficiencies as set forth above. The first question is whether such decisions are not supported by the evidence, are clearly erroneous, and are not in accordance with law.

The second issue arises from the refusal of the trial judge to admit evidence concerning petitioners' net worth and disbursements for 1949. The second question is whether such evidence is relevant and material, as some proof that the Commissioner's determination of additional income is erroneous, in a case where the Commissioner is challenging the reliability and sufficiency of taxpayer's books and records.

SPECIFICATION OF ERRORS RELIED ON

1. The Tax Court erred in treating as evidence the legal presumption of correctness which attaches to the Commissioner's determination.

2. The Tax Court erred in finding as fact that petitioners realized additional income of $19,563.66.

3. The Tax Court erred in that its decisions are not supported by the evidence, are clearly erroneous, and are not in accordance with law.

4. The Tax Court erred in refusing to admit evidence relating to petitioners' net worth and disbursements for 1949 as some proof that additional income of $22,563.66 was not realized. At the trial petitioners offered testimony evidence of Mr. Showell regarding the personal disbursements of petitioners for the year 1949 (R. 84, 85). The evidence was offered to supplement evidence already in the record concerning petitioners' beginning and ending net worth for the year 1949 (R. 75-84; Exhibit 9) as some proof that personal expenditures were not such that the net worth statement could be incorrect (R. 85). The Tax Court sustained

an objection by Commissioner's counsel that the offer of evidence regarding petitioners' personal disbursements was immaterial and irrelevant (R. 85, 86) although petitioners' counsel stated when net worth and disbursements evidence was first offered that it was appropriate evidence to prove that a deficiency was not possible (R. 77).

ARGUMENT

I

In turning to the initial issue, petitioners note that the first three errors specified are related and interwoven. For instance, whether the Tax Court's decisions are not supported by the evidence, are clearly erroneous, and not in accordance with law, is connected with the question of whether the Tax Court treated as evidence the legal presumption of prima facie correctness which attaches to the Commissioner's determination. Likewise, whether the Tax Court erred in finding as fact that petitioners realized additional income of $19,563.66 is dependent on whether its decisions are not supported by the evidence, are clearly erroneous, and not in accordance with law.

The review of Tax Court decisions by United States Courts of Appeals are taken and treated in the same manner and to the same extent as decisions of the district courts in civil actions tried without a jury. Section 7482, Internal Revenue Code of 1954. This means that the findings of fact of the Tax Court are subject to scrutiny by the United States Courts of Appeals, and the Tax Court's decision will be set aside if clearly erroneous, *Hatch's Estate v. Commissioner,* 9 Cir., 1952, 198 F. 2d 416, if not supported by the evidence, *Wright-Bernet, Inc. v. Commissioner,* 6 Cir., 1949, 172 F. 2d 343, and not in accordance with law, *Gillette's Estate v. Commissioner,* 9 Cir., 1950, 182 F. 2d 1010. A finding of fact is clearly erroneous when, even though there is evidence to support it, the appellate court "on the entire evidence is left with the definite and firm conviction that a mistake has been committed." *Gillette's Estate v. Commissioner,* 9 Cir., 1950, 182 F. 2d 1010, 1014. Should the Tax Court decision lack substantial

evidence to support it, it will be considered as clearly erroneous and not supported by the evidence. *Wright-Bernet, Inc. v. Commissioner,* 6 Cir., 1949, 172 F. 2d 343. If "every part of the substantial evidence properly related to the whole of the evidence points unmistakably to the conclusion that it is wrong," the decision is "not in accordance with law." *Gillette's Estate v. Commissioner,* 9 Cir., 1950, 182 F. 2d 1010, 1014.

In the instant case, the Commissioner offered no testimony or documentary evidence except the original federal income tax return of each petitioner. Petitioners, on the other hand, placed into the record the testimony of four witnesses (R. 41-116) and several pieces of documentary evidence (R. 44, 66, 67, 70, 72, 77) contra to the Commissioner's determination. The testimony of none of the witnesses was impeached on cross-examination (R. 44, 52-54, 87-104, 107-109, 113-115, 116-117). In fact, the testimony of petitioner Jack Showell was the only foundation in the record for virtually every finding of fact made by the Tax Court except four and the ultimate finding of fact. When the majority opinion ruled that the burden of proof had not been carried, it both violated the rule laid down in *Hemphill Schools, Inc. v. Commissioner,* 9 Cir., 1943, 137 F. 2d 961, that the presumption of correctness attaching to the Commissioner's determination does not constitute evidence, and misapplied the burden of proof rule.

There is an important difference between the burden of proof and a legal presumption. The latter is merely procedural. Thus, when it is said that there is a presumption that the Commissioner's determination is prima facie correct, the reference is to a legal presumption. Consequently when contrary evidence is placed in the record, the presumption of prima facie correctness is gone completely and the case is wide open. *J. M. Perry & Co. v. Commissioner,* 9 Cir., 1941, 120 F. 2d 123; 9 Mertens, *Law of Federal Income Taxation* 50.71 (1943). Certainly the entire record herein shows clearly that contrary evidence existed. Therefore the only question left for the Tax Court to decide was whether petitioners carried their burden of proof.

The burden of proof is the duty of the person alleging the case to prove it. It never shifts. McKelvey, *Evidence* 94 (5th ed. 1944). In order to carry his burden of proof, a taxpayer must prove his facts before the court by a "preponderance of the evidence," *Schilling Grain Corp.,* 1927, 8 B.T.A. 1048, such as would reasonably support a verdict for a plaintiff in an ordinary action for the recovery of money, *Burnet v. Niagara Falls Brewing Co.,* 1931, 282 U.S. 648, 51 S.Ct. 262, 75 L.Ed. 594.

However, the Tax Court required much more of these particular petitioners than required by the Supreme Court in the *Burnet* case when the Tax Court held herein:

> ". . . Accordingly, we can not accept the evidence as *conclusively* proving the full amount of the claimed losses . . ." (R. 20). (Emphasis supplied)

Petitioners submit that conclusive proof is not required. Whether there was a preponderance of the evidence such as would reasonably support a verdict for a plaintiff in an ordinary action for the recovery of money is the proper test. One thing is certain. If conclusive proof is required of taxpayers to carry the burden of proof in civil tax cases, the right of appeal from the Commissioner's determination has a hollow ring to it. Very little, if anything in life, can be proved conclusively. No doubt that is why the Supreme Court of the United States had the following to say regarding the burden of proof:

> "Unquestionably the burden of proof is on the taxpayer to show that the commissioner's determination is invalid. . . Frequently, if not quite generally, evidence adequate to overthrow the commissioner's finding is also sufficient to show the correct amount, if any, that is due. . . But, where as in this case the taxpayer's evidence shows the commissioner's determination to be arbitrary and excessive it may not reasonably be held that he is bound to pay a tax that confessedly he does not owe, unless his evidence was sufficient also to establish the correct amount that lawfully might be charged against him. . ." *Helvering v. Taylor,* 1935, 293 U. S. 507, 515, 55 S.Ct. 287, 79 L.Ed. 623.

Nevertheless, even if the Tax Court had correctly applied the aforementioned "preponderance of the evidence" rule in determining if petitioners had carried their burden of proof, the pe-

titioners would have prevailed. This is evident from both the quality and quantity of the evidence introduced by petitioners, and the utter lack of any by the Commissioner.

In the first place, the Commissioner's own action in asserting his deficiency notices based solely on the accuracy of petitioners' permanent record (Exhibit 3) constitutes acceptance of the correctness of petitioners' permanent record relating to the business of booking bets. Since the Tax Court found as fact that losing bets were first deducted from winning bets before entries were made in both the "Gain" and "Loss" columns of Exhibit 3 (R. 15), the use of the total of entries in the "Gain" column as the sole basis of the deficiency amounted to acceptance of petitioners' method of recording losses. Surely the Tax Court cannot find, without substantial evidence or even some evidence to support the finding, that petitioners' record (Exhibit 3) is not reliable while at the same time sustaining deficiency notices based solely on the correctness of that same record.

In its opinion, the Tax Court dealt with this point by making two answers. First, it said that petitioners cannot so "complain" since the Commissioner has allowed some losses by virtue of his acceptance of the "Gain" column (R. 20). Petitioners submit that the fact that the Commissioner has allowed losses used in computing the entries under the "Gain" column is not some or any evidence of the unreliability of the entries appearing in the "Loss" column. The second answer was that the gain figures, "in a sense," were admissions against interest and so were more reliable than the "bare 'Loss' figures" (R. 20). To this, petitioners point out to the Court that the phrase "bare 'Loss' figures" is misleading for it suggests that the "Loss" column entries were not computed and recorded in exactly the same manner as the entries made in the "Gain" column. It is because such was the case, and the Tax Court so found (R. 14, 15), that the Commissioner's action constitutes acceptance of both the method used to record losses and the reliability of the permanent record (Exhibit 3). To hold that the "Gain" figures are admissions against interest and therefore more reliable than the "bare 'Loss' figures" does not

supply, from the record, evidence to support a finding that Exhibit 3 was unreliable. It is not upon such threads of sand that findings of fact are tied. Nor does it follow that the Commissioner need not have produced evidence sustaining the unreliability of Exhibit 3. When the legal presumption of correctness attaching to his determination evaporated at the trial, the fact that he accepted the method and accuracy of recording gains and losses, which was the same for both the "Gain" and "Loss" columns, by using those appearing in the "Gain" column as the sole basis of his deficiency notice, made it mandatory for him to introduce evidence to support a finding that the "Loss" column figures were unreliable. If not, the Commissioner can sustain his deficiency notices in the Tax Court, even after his presumption of correctness has disappeared, with no more authority than the careful use of a pair of scissors. Can all entries unfavorable to the Commissioner, which are computed and recorded in the same manner as those favorable to the Commissioner, be placed in an isolation ward called "Unreliable" simply by classifying the entries favorable to the Commissioner as admissions against interest? Furthermore, it is not correct to say that the gain figures are admissions against interest, and therefore more reliable than the loss figures. The reason is that the figures appearing in the "Loss" column are also admissions against interest because total gains from winning bets were subtracted from total losses from losing bets and the difference entered in the "Loss" column. By subtracting these gains from losses, thereby reducing the losses claimed, petitioners made an admission against interest. Therefore, according to the Tax Court's reasoning, the "Loss" figures are just as reliable as the "Gain" figures.

However, testimony regarding the Commissioner's own action was not the only step which the record shows was taken by petitioners to carry their burden of proof. In addition, the uncontradicted testimony of three witnesses, including the taxpayer, affirmed the complete accuracy of petitioners' permanent record (Exhibit 3). To begin with, the testimony of petitioner Jack Showell was not impeached by cross-examination. True, the Tax Court dismissed his testimony insofar as it verified the accuracy of

the figures appearing in the "Loss" column by saying that it was "self-serving" (R. 20). Yet the testimony of this same person served as the sole basis for virtually every finding of fact made by the Tax Court. This raises the question of the respect which such a finding should be accorded by this Court in the light of the entire record. All testimony of all taxpayers is selfserving unless the taxpayer is testifying that the Commissioner's determination is correct. What is significant is whether his testimony was believed or not, and was supported by other evidence. If it is not worthy of belief, a finding to that effect should be made. However, that could not be done by the Tax Court because the taxpayer's forthright testimony was the foundation of practically all of its findings of fact, and the correctness of his own permanent record (Exhibit 3) was the sole basis of the Commissioner's determination. As this Court said in *Grace Bros., Inc. v. Commissioner,* 9 Cir., 1949, 173 F. 2d 170, 174:

> "It is axiomatic that uncontradicted testimony must be followed. Chesapeake and Ohio Railway Company v. Martin, 1931, 283 U. S. 209, 216, 217, 51 S.Ct. 453, 75 L.Ed. 983; San Francisco Association for the Blind v. Industrial Aid for the Blind, 8 Cir., 1946, 152 F. 2d 532, 536; Foran v. Commissioner, 5 Cir., 1948, 165 F. 2d 705. The only exception to the rule occurs when we are dealing with testimony by witnesses who stand impeached and whose testimony is contradicted by the testimony of others or by physical or other facts actually proved or with testimony which is inherently improbable."

Petitioners suggest that the Tax Court cannot lightly sidestep the above rule by simply inserting a sentence in its opinion that the testimony of the taxpayer was "self-serving."

Furthermore, Mr. Showell's testimony respecting the accuracy of Exhibit 3 was corroborated by a responsible former City Manager and City Commissioner of Phoenix, Arizona, named Houston L. Walsh who had no interest in the case (R. 110, 111). Mr. Walsh testified that he helped petitioner keep books and records regarding the latter's betting business (R. 111), and that he actually posted about half of the entries on Exhibit 3 (R. 112). Mr. Walsh stated that first either he or Mr. Showell would call out each of the winning tickets to the other who would add them

on an adding machine (R. 110-115). Then the tickets would be handed to the other person while the person who had previously called them out would take over the adding machine (R. 110-115, 14, 15). The same procedure was used for all losing tickets, and the two men always exchanged places to make sure the totals were correct (R. 114, 115, 14, 15). When the totals of all winning bets and all losing bets were thus doublechecked, the total of losing bets was deducted from the total of winning bets. (R. 110-115, 14, 15). The resulting figure, which was either a net gain or a net loss, was entered in the "Gain" column if a net gain and in the "Loss" column if a net loss (R. 110-115, 14, 15). The entries made in both the "Gain" and "Loss" columns of Exhibit 3 were the result of this procedure, and such was found to be fact by the Tax Court (R. 14, 15). About half of such entries made on Exhibit 3 were made by Mr. Walsh (R. 62, 112).

With respect to the uncontradicted testimony of Mr. Walsh, which was actually strengthened on cross-examination (R. 113, 114), the Tax Court said:

> ". . . Walsh had no first hand knowledge of the accuracy of the figures *read off to him* by the petitioner from his slips." (R. 20). (Emphasis supplied)

Such a statement infers that Mr. Walsh's role was passive in that he too did not call out the winning and losing bets from the individual slips to petitioner. The record (R. 110-115) including the Tax Court's own findings of fact (R. 14, 15) utterly refutes such an inference. Furthermore, it is a convenient way of dismissing any testimony ever offered to corroborate the accuracy of any written record. Only one person could ever have first hand knowledge of the accuracy of the individual slips, and that is the taxpayer whose testimony, but only in particular respects, was ignored by the Tax Court as "self-serving." What this statement says in effect is that some of the individual slips *might* have been inaccurate. It is not a statement that there is evidence in the record to show that Jack Showell kept individual bet slips which were wrong. If what the Tax Court is really saying is that the accuracy of each winning and losing bet slip must be proved before petitioners could carry the burden of proof, it is holding in substance

that every dice table in Las Vegas, Nevada, must keep a record showing the name and address of every bettor, the number of times each placed a bet, the amount of each bet, the number of times the dice were rolled, and the number of times each person won or lost. And, if that were done, would it not then be necessary to offer the sworn testimony of each of these bettors to prove the accuracy of the individual bet slips since the testimony of the proprietor would be self-serving? Possibly Society would be well served by such a requirement since it would be difficult for organized gambling to exist, but is that the criteria applied by the Internal Revenue Code or used in determining whether a burden of proof has been carried?

Nor was the testimony of Mr. Showell and Mr. Walsh the only evidence of the reliability of Exhibit 3. Three cancelled checks were available in support of three expense items found in the "Loss" column. They were Exhibits 4, 5, and 6 (R. 66, 67).

It is not suggested to this Court that any of the above factors, standing alone, should have been accepted by the Tax Court as carrying petitioners' burden of proof. However, a comprehensive view of all of them leaves little doubt that the Tax Court has incorrectly treated the legal presumption of correctness which attaches to the Commissioner's determination as evidence which was used to balance out the cumulative effect of petitioners' evidence. Further, even assuming that it did not treat the legal presumption of correctness as evidence, it misapplied the burden of proof rule.

With respect to certain important facts found by the Tax Court, it is submitted that there is no evidence of any kind to support them. For instance, it was found as fact that the petitioner Jack Showell destroyed the individual slips of paper upon which each bet was noted "in order to maintain secrecy respecting his customers and for the purpose of creating an excuse for not producing them if and when called upon." (R. 14). There is absolutely nothing in the record upon which such a finding can be based. Neither on direct or cross-examination was testimony even remotely to that effect developed (R. 57-110). Instead, petitioner testified, on cross-examination, that he had kept his records for the

betting business in the same fashion for fifteen years (R. 104). If the Tax Court's said finding was based on the assumption that such must have been true because petitioner knew that booking bets on football, baseball and basketball games was illegal in Arizona, it is founded on an erroneous assumption. The reason is that petitioner Jack Showell was a litigant in a case before the Arizona Supreme Court which held that booking bets on horse races did not violate the criminal gaming statute of Arizona. *Engle v. State of Arizona,* 1939, 53 Ariz. 458. There the court emphasized that Arizona law does not prohibit gambling per se. "It is only certain specified forms of gambling that are forbidden, and it is only the keepers of houses where these particular forms are carried on who are punished by the provisions of article 9, *supra.*" *Engle v. State of Arizona,* 1939, 53 Ariz. 458, 470. An examination of the court's opinion reflects that it held that an implement or devise determining who won or lost and which was an integral part of the gambling was necessary before the statute was violated. Since the petitioner, Jack Showell, had been a party to a 1939 suit to determine the extent of Arizona's gaming statutes, he knew that the business of booking bets was not illegal under Arizona's criminal statute.

Next the Tax Court found that:

> "Although petitioner retained the cancelled checks issued by him in 1949 in payment to certain winning bettors, when asked by the revenue agent for the names and addresses of persons to whom he had paid winning bets, and the amount paid to each, the petitioner informed him that he was unable to give him that information." (R. 17).

The record does not show that Mr. Showell was ever asked for cancelled checks. In fact, Mr. Showell testified as follows:

> "Q. Did Revenue Agent, Mr. Mende, ever ask if he could examine any of those checks?
> A. No." (R. 61).

Agent H. L. Mende himself testified as follows with respect to the checks:

> "Q. Did you ask Mr. Showell if you could have any cancelled checks?

A. The cancelled checks would not have any bearing on it.

The Court: Did you ask him or did you not?

A. I do not remember." (R. 50)

However, more important is the fact that the retained cancelled checks to certain bettors actually would not have any bearing on the problem because a check payment had no relation to either wins or losses (R. 74).

In the light of the foregoing arguments, it is respectfully submitted that the Tax Court's decisions are not supported by the evidence, are clearly erroneous, and not in accordance with law because:

(1) It erroneously treated the legal presumption of correctness attaching to the Commissioner's determination as evidence.

(2) It misapplied the burden of proof rule by requiring petitioners to *conclusively* prove their case.

(3) From the entire record, petitioners did carry their burden of proof by a preponderance of the evidence such as would support a verdict for a plaintiff in an ordinary action for the recovery of money.

(4) Its ultimate finding of fact that petitioners realized $19,563.66 of additional income is in conflict with its specific findings of fact and is not supported by substantial evidence.

II

Although the Tax Court's majority opinion decided that the evidence did not "conclusively" prove the full amount of the claimed losses (R. 20) and the dissenting opinion indicated proof was impossible because individual slips were not retained (R. 26), the trial judge, who wrote the dissenting opinion, refused to allow petitioners to introduce material evidence concerning their net worth and disbursements as some proof that additional income was not realized (R. 86). After admitting into evidence, as Exhibit 9, a beginning and ending balance sheet for 1949, and considerable testimony of petitioner Jack Showell concerning the entries therein, the trial judge refused to accept testimony concerning petitioners' disbursements for 1949. Such evidence is, of course, necessary

before a beginning and ending net worth can have any weight or relevance. The trial court was informed by petitioners' counsel before the balance sheet (Exhibit 9) was offered that it was appropriate evidence for the reason that if the Commissioner can prove a deficiency on the basis of the net worth and disbursements method, it followed that a taxpayer could disprove a deficiency by the use of the same method (R. 77). In other words, is the relevance of evidence based on the net worth and disbursements method controlled by whether the Commissioner's deficiency was based on that method, or is it not relevant in a case where the Commissioner is attacking the adequacy and reliability of petitioners' records? Petitioners submit that it was not proper for the Tax Court to sustain the Commissioner because petitioners' record was not reliable and at the same time deny them the opportunity to present this type of evidence as some proof that the Commissioner's determination was incorrect. To say that proof must be limited to the losses themselves is to say that the Tax Court is not interested in whether the petitioners actually realized additional income or not. An appeal to the Tax Court is from a determination that a taxpayer has a deficiency in income taxes. It is not an appeal limited to the narrower question of whether *conclusive* proof can be presented sustaining losses. A taxpayer's income tax liability should not be determined on such a fragmentary basis particularly in a case where it is apparent from the entire record that the Commissioner has not disallowed specific losses at all, but has rejected a portion of petitioners' permanent record as being unreliable. That is why petitioners' counsel stated at the trial that "This is a case where the deficiency between the parties is a matter of the petitioners' records." (R. 38).

In the dissenting opinion, the trial judge said:

> . . . "The impossibility of proving the material facts upon which the claim rests does not relieve the taxpayer of his burden of proof. . ." (R. 26)

What Judge Withey is saying is that if a taxpayer's records do not, in the Tax Court's opinion, which opinion is voiced after the taxable year involved has expired, satisfy Section 54 of the 1939 Internal Revenue Code, there is no possible way of overturning the

Commissioner's determination. Aside from the fact that no case has so interpreted Section 54, petitioners submit that such a view elevates some evidence of a fact (an entry made on a piece of paper) to the status of fact itself. Certainly the Tax Court would not hold that the mere existence of the discarded records would prove the fact of deductions or of income. That is why the Commissioner is entitled to prove a deficiency in income tax via the net worth and disbursements method either where no records exist or where they are unreliable. Such being the case, cannot a taxpayer offer net worth and disbursements evidence as some proof that the Commissioner's determination is erroneous in a case where the Commissioner is attacking the reliability and sufficiency of the taxpayer's records?

Suppose the Commissioner issued a notice of deficiency in the sum of $1,000,000 for the taxable year 1953 to any one of us. In order to carry the burden of proof, the Tax Court would require, as an absolute condition precedent, the existence of written records disproving the deficiency. Furthermore, it would later determine whether such records were adequate under the meaning of Section 54. If it did decide that certain records were lacking under Section 54, it would be impossible for a taxpayer to carry the burden of proof.

If such an approach is approved, the Commissioner will have obtained a new method of reconstructing income which eliminates any need for the use of the net worth and disbursements method, and which is an unbeatable weapon against the taxpayer because no defense is available. After all, when the Commissioner uses the net worth and disbursements method, the taxpayer can at least defend on that theory. Here there is no defense.

Also, such a view actually places a taxpayer who has kept a permanent record in a much less favorable position than one who has not bothered to keep any records. It is difficult to conclude that Section 54 was designed to accomplish such a result.

Consequently, when the Tax Court refused to admit evidence concerning petitioners' disbursements for the year 1949, to supplement evidence concerning beginning and ending net worth which

was offered as some proof that the Commissioner's determination was erroneous, it was in error.

CONCLUSION

The decisions of the Tax Court in the instant cases are erroneous and should be reversed.

Dated: Phoenix, Arizona
October 1, 1955

Respectfully submitted,

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